

**African aviation:
Should governments own
their own airlines?**



airport

airline

cargo



Lufthansa Consulting

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No standard solutions exist nor are there any examples of well-managed government-owned airlines. But it is widely believed that in the medium to long term the remaining national airlines in Africa should be privatized. There is a natural conflict of interest between governments and airlines since they usually pursue different aims. Governments that still own airlines should therefore consider gradually divesting their stakes in national carriers in order to pave the way for a private enterprise corporate governance model which will allow management to base all its decisions on economic facts rather than on political ones.

Due to mandatory capital requirements and high underlying economic and political risks, a vast majority of these airlines, such as Egyptair, South African Airways and Air Senegal, were either directly founded by their respective governments or nationalized. Aviation has always had a profound impact on the economic development of nations around the globe. Air transport allows countries whose inhabitants would otherwise be isolated due to poor or non-existent ground transportation to maintain national unity. It also links nations by promoting trade and development. Indeed, air transport plays a fundamental role in developing a nation and its economy. The creation of employment, both directly and indirectly, investment in infrastructure and local businesses and tourism serves as a key economic growth driver.

Historically, governments have intervened in the operational decision-making processes of “their” airlines, with little regard for profits or the cost of operations (e.g. for opening up unprofitable routes, free flights for government officials, etc.). Although air transportation has increased in importance in terms of private and business travel and cargo transportation, growing competition from both low-cost and privatized airlines has reduced governments’ interest in nationalizing airlines. Problems such as mismanagement and lack of expertise in running an airline (government officials are usually not aviation experts) have caused governments to pour millions into their airline operations. Air Afrique is a well-known example of a classic conflict between government and private sector interests. The involvement of eleven different governments made it even more difficult to define a common interest. The attempt to integrate the aviation activities of eleven African countries into one pan-African airline with a view to achieving economies of scale and a mandatory size to compete with international carriers from Europe finally failed in February 2002. This African aviation industry “field test” generated debts of about US\$0.5 billion. Other examples include Ghana Airways, where the government had to absorb debts of US\$160 million before closing down the operation in August 2004. Nigeria Airways was also forced into liquidation after the carrier was unable to pay its monthly wage bill of US\$1.3 million. This trend among African airlines towards failure due to high levels of accumulated debt, corruption and mismanagement raises the question: Should governments own their own airlines?

Although many African airlines are still state controlled, dynamic changes are beginning to take place. The ongoing liberalization program on the continent has brought the first airline privatizations, along with intense competition from interna-



tional mega carriers, low-cost start-ups, and cooperations, such as that between KLM and Kenya Airways, South African Airlines and Air Tanzania, as well as Royal Air Maroc and Air Senegal.

Some African governments have already succeeded in overcoming difficulties in running a national carrier. Government-owned Air Botswana has been operating profitably for the last eight years, with operating profits in 2004 improving 28% over the previous year. Encouraged by this success, the government attempted a privatization process in 2004. Royal Air Maroc has also had a successful turnaround, with revenue reaching US\$861 million and net profits of US\$ 21.5 million in 2004. In Uganda, the government decided that its best option was to shut down its loss-making airline and open up the market for competitors. Today, five private airlines operate domestic and international services into Uganda. Through its restructuring process, Air Madagascar achieved a net profit of US\$3.2 million in 2004, only two years after it posted an operating loss of US\$4.1 million. Privatization will be the next logical step (see Case Study below). After its privatization in 1996, Kenya Airways was able to generate a sustainable operating profit. This example shows that African airlines in private hands can indeed be run successfully. At the same time, most government-owned airlines operating intercontinental routes are still in crisis.

Change in ownership

How can governments divest their investment in their national carriers? Thanks to the Yamoussoukro Declaration of the 1980s, which enables privatization in the air transportation sector, four main options have become available. First, the airline can remain at the status quo, but it runs the risk of bankruptcy due to intense private competition and a lack of commitment on the part of the government to provide continuous financial subsidies. Second, a government may decide to sell its stake in the airline, with the risk of losing control over the national airline's operations. However, privatizing national airlines that reveal substantial financial difficulties will only hasten their collapse. A government would thus be best off creating an environment that will ensure a smooth transition from state ownership to private ownership. This leads to option three: restructure and then sell, making the airline more attractive to potential investors. Finally, there is option four, which foresees shutting down operations and then liberalizing the market for competition, as seen in Uganda.

Historical developments in Europe might serve as a point of reference for the African continent. Successful airlines today, such as Lufthansa, Iberia and Air France, were first restructured and made fit for international competition before the actual privatization was initiated. Following the success in Western Europe, the privatization process has now swept into Eastern Europe.

To best retreat from ownership, governments can retain minority control through a phase-out model, as seen in the examples of Kenya Airways or Royal Air Maroc. The objective here is to turn the airline around, or sell off the airline directly and allow external competition to serve national routes.



Competition in Africa is slowly increasing: yields are likely to drop further while rising costs will put an extra burden on the already struggling state-owned airlines. In addition, deregulation is sweeping across the continent, a fact which will urge governments to start preparing better for the necessary privatization of the remaining state-owned airlines or else keep on wasting funds that would be badly needed elsewhere.

Case Study on Air Madagascar

The Government of the Republic of Madagascar was pouring millions into its national carrier in an attempt to rescue the crisis-ridden airline, but to no avail. Acting upon the advice of Lufthansa Consulting, the government decided to undertake a wide-scale restructuring of the airline. Thanks to the restructuring process, Air Madagascar has achieved revenue improvements, cost reductions, plus enhancements in flight safety and services offered. Furthermore Air Madagascar has become an attractive cooperation partner for other airlines through code-sharing, namely Thai Airways, Inter Air South Africa and Air Mauritius.

At the end of a political crisis in May 2002, the Government of the Republic of Madagascar hired Lufthansa Consulting to conduct a holistic restructuring of the struggling national flag carrier. At that time, the financial situation of the airline was highly problematic. Operations had shrunk to approximately 50% before the crisis. Aircraft had been repossessed by the leasing companies and heavy fines had been imposed on Air Madagascar.

A thorough assessment of all areas of Air Madagascar was conducted in order to identify the main areas of improvement and create a comprehensive restructuring plan. The immediate objective of this plan was to ensure Air Madagascar's survival and stop the financial hemorrhaging of the company. In addition, a three-year-Business Plan was developed to define medium-term corporate goals and strategies.

In October 2002, following a request by the President of the Republic of Madagascar, Lufthansa Consulting appointed a Chief Executive Officer as well as a Chief Financial/Commercial Officer to run Air Madagascar. These two executive managers are supported by a pool of experts from Lufthansa Consulting and the Lufthansa Group.

As a very first step, the new management team organized a Creditors Conference during which creditors were successfully convinced to reduce Air Madagascar's existing debt by 50%. It was also agreed that the remaining debt would be repaid from operating cash-flow during the following three years.



Since the start of the restructuring process in 2002, the following results have been achieved:

- Increase in operating result: From a US\$4.1 million loss in 2002 to a record profit of US\$11 million in 2003 and US\$3 million in 2004 _ the latter despite growing oil prices.
- Improvement in operational performance: The average seat load factor increased from around 55% in 2002 to approx. 70% in 2004.
- Introduction of two B767s for long-haul services and expansion of the international network with an increase in services to Paris and the opening of two new routes to Milan and Bangkok
- Incorporation of three new aircraft for domestic and regional services, as part of a fleet renewal and expansion program (aircraft to be delivered in late 2005)
- Introduction of a new branding and corporate identity concept, including the development of a new corporate logo and the complete redesign of the cabin interior and crew uniform.

Source: Lufthansa Consulting data, 2005

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